

FX markets: Lowering your sights

FX markets have reacted to news of a much closer US election by selling currencies most exposed to the global recovery story and buying USD and JPY. Certainly, the prospect of at least smaller fiscal stimulus, if not an outright contested election – combined with poor Covid-19 trends – favour more defensive positioning this month



Election 2020, Tokyo, Japan - 04 Nov 2020

Source: Shutterstock

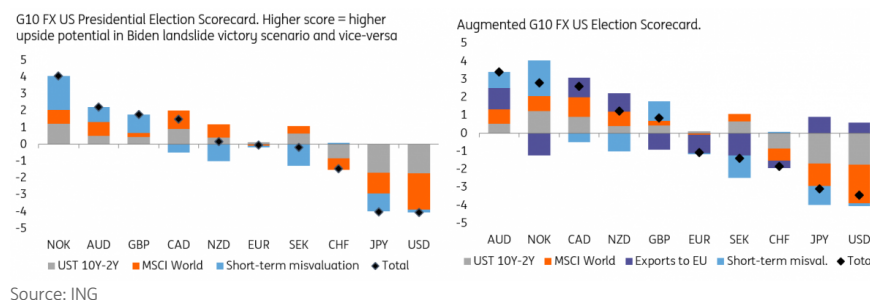
Scaling back the rally

FX markets went into the election priced for a Biden clean sweep. Large fiscal stimulus expected in January, a return to the rules-based trading system, and a Federal Reserve ready to run the economy hot had all contributed to the broad dollar decline and (helped by Covid trends in Asia) generated good demand for those currencies exposed to a rebound in global activity – or the reflation trade.

Instead, it looks very much like the Democrats will struggle to grab the Senate (suggesting a smaller fiscal stimulus as parties continue to bicker) and that whichever candidate secures 270 electoral college votes, that vote could well be challenged. A contested election looks a clear negative for risk assets, recalling the 8% decline in the S&P 500 back in November 2000 as the Supreme Court spent a month deliberating over a Florida recount.

We have been highlighting FX market sensitivities to the global recovery trade in articles such as the [G10 FX Election Scorecard](#) and these correlations have been holding up well. Further pressure on US equities and a flatter US yield curve would see Norway's krone and the Australian dollar as the most exposed, while the Japanese yen and US dollar should perform better during this uncertain environment. For choice, we would probably favour the JPY over the USD given the risk of a 'sell US' mentality emerging were the election result to be contested in the courts.

Which currencies are most exposed to the reflation trade/Biden clean sweep?



EUR: The headwinds are growing

Despite Europe heading into second wave lockdowns, EUR/USD had been holding up quite well. This was probably a function of the broad dollar decline – or effectively the global recovery story trumping the setback in Europe. After election night, the global recovery story is clearly providing less support now and instead, the European double-dip may play a greater role in EUR/USD pricing.

Here, the European Central Bank looks set to top up quantitative easing in December – [a move the ECB sees as effective in keeping a lid on the euro](#). Until the US election result is clear, we suspect that EUR/USD trades in a 1.15-1.20 range – gyrating lower on prospects of a Trump presidency (more protectionism, targeting Europe?) and higher on a Biden presidency. Into 2021, however, we still lean towards a post-Covid global recovery trade coming through next summer. An ensuing broad-based dollar decline could still see EUR/USD trade up to 1.25 – but headwinds are growing to that call.

So far, emerging market currencies have actually held up a little better than expected. That may be because both the Fed and the ECB have light-trigger fingers when it comes to supplying fresh liquidity and that low core rates continue to favour a drive out along the credit curve into high yield, emerging market FX. We like this story in 2021, but again feel that an uncertain November – including the threat of renewed US lockdowns in December – favour patience when returning to the EM growth/yield investment theme.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.